CORPORATION FOR ENTERPRISE DEVELOPMENT

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November 25, 1997

Ms. Cynthia L. Johnson
Director, Cash Management Policy and Planning Division
Financial Management Service
U.S. Department of the Treasury
Room 420
401 14th Street, S.W.
Washington, DC 20227

Dear Ms. Johnson:

The Corporation for Enterprise Development (CFED) — a non-profit economic development, policy analysis, research, and demonstration organization — is pleased to submit comments on the proposed rule published in 31 CFR Part 208, which requires all Federal payments made after January 1, 1999 to be made by Electronic Funds Transfers, or "EFT '99."

We would like to state up front that our central interest in commenting on these rules is to facilitate saving and the acquisition of productive assets by low-income people, for we believe that it is primarily through the accumulation of savings and assets that people move forward economically. It is our view that EFT '99 creates an immense opportunity to foster saving and financial inclusion — *or* a threat to further isolate low-income people and communities, depending on how it is used.

For 18 years, CFED has worked at the international, national, state, and community levels to understand and develop effective economic development strategies to build economic independence. Based on our research and experience, we believe that facilitating and mobilizing savings and investment in low-income communities is not merely supplemental but rather is *crucial* to building sustainable economies and unleashing entrepreneurial endeavor, spurring home ownership and increasing educational levels. Unfortunately, fully one-third of American households have no or negative investable assets, and half of all Americans have less than $1,000 in net financial assets — all of this at a time when the price of admission to the mainstream economy (the cost of an adequate education, the downpayment on a home, and the money needed to start a small business) has risen.

Also, in July of this year, CFED gathered 32 leading experts on development finance, banking, economic development, community development and international microfinance to brainstorm promising means of facilitating and mobilizing savings in low-income communities. The report from that meeting — *20 Promising Ideas for Mobilizing and Facilitating Savings in Low-Income Communities in the U.S.* — is enclosed. These experts identified EFT '99 as perhaps the greatest threat and opportunity in this area and, accordingly, strongly endorsed using EFT '99 to help build a savings infrastructure in low-income communities.

Finally, CFED has been working with a national network of Community Development Corporations (CDCs), Community Development Financial Institutions (CDFIs), microenterprise programs, churches, family service agencies, foundations, and others interested in Individual Development Accounts (IDAs) — matched savings

EFT #085

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accounts earmarked for home ownership, business capitalization, and post-secondary education; further information on IDAs is also enclosed. These groups recognize the importance and promise of savings facilitation and mobilization as a key dynamic for building sustaining economies. We will be sharing these comments with them, but these comments also reflect their input.

Thankfully, in our reading of the proposed rule, it appears that savings opportunities not only exist, but in some respects would be welcomed — especially for the 10 million "unbanked" persons with whom we and Treasury are most concerned — provided, of course, that transaction and savings/investment features can be combined at a cost reasonable to both the designated financial agent and the customer.

Savings and Economic Development

Before we provide specific comments on the proposed EFT '99 regulations, we would like to briefly add a few more remarks on the importance of savings facilitation to economic development.

First, *savings are an economic nutrient, not economic dessert.* At the threshold level, savings are a buffer against inevitable accidents and illnesses. More importantly, however, savings offer a point of economic leverage: they represent the ability of people to invest in themselves and their children — regardless of who else may be interested. Granted, saving involves more sacrifice the poorer you are. Waves of penniless immigrants to this country, like our grandparents, sacrificed greatly to maximize and pool their savings. They regarded those hard-won savings as the door to a better economic future for themselves and, more commonly, for their children and grandchildren.

Second, *poor and low-income people have always saved.* For 60 years, Community Development Credit Unions (CDCUs) have operated in some of the nation's poorest communities to foster savings. As of 1995, more than 170,000 savers with a median family income of $19,000 had deposited $250 million in savings with an average balance of $1,200. Also, in response to CFED's 13-site, $12 million national IDA demonstration — the Downpayments on the American Dream Policy Demonstration — dozens of focus groups with low-income families revealed their willingness (indeed, their eagerness) to save between $10 to $40 per month to invest in homes, businesses, education, or a fallback in emergencies. Also, early experiments with Electronic Benefit Transfers (EBT) in several states disclosed *de facto* savings (or balances) in many accounts.

Third, we believe that *savings behavior is primarily institutionally (that is, not culturally) determined.* People in the U.S. save and acquire assets because institutions — governments, employers, and banks — support and encourage such activities (by, for example, providing tax breaks, matching deposits, and financial returns, and by making the transactions simple and convenient). Classical economic theory posits that saving occurs for people who prefer future over present consumption; similarly, most Americans tend to regard savings as the residue of income minus expenses. We believe, however, that greater evidence exists for this "institutional" view: that people — low-income included — will in fact save if the right incentives are provided and the right institutions support it. In Singapore, for example, the mandatory matched savings system has resulted in a 92% home ownership rate, the highest level of saving reserves per capita in the world, and one of the fastest growing economies in the world. And in Indonesia, the Bank Rakyat Indonesia manages $2.7 billion in

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savings of low-income Indonesians in 13 million accounts averaging $185. The bank is profitable and self-sustaining as a result, enabling it to extend microloans to more than 2 million low-income entrepreneurs.

And fourth, *savings beget investment.* Low-income savers can and will invest in small businesses, home ownership, and post-secondary education — all of which yield long-term economic and social benefits to families, communities, and the nation. Even small savings can generate big changes. For example, half of all businesses started in the U.S. each year are capitalized with less than $5,000. The average downpayment needed on a home purchased by low- and moderate-income families is less than $3,000. And the average annual tuition at a community college is less than $1,200. Further, we know that these investments work. Low-income home ownership programs (like those run by the Neighborhood Reinvestment Corporation) have successfully increased home ownership by low-income families while achieving lower default rates than Veterans Administration and Federal Housing Administration programs. Rigorous evaluations of self-employment programs for welfare recipients and other low-income people have found that 80% of their businesses survive at least two years, that their businesses create jobs (an average of 1.5 jobs created per business), and that these businesses increase the income, assets, self-esteem, and employability of the owner/entrepreneur. And, finally, we know that investments in education pay off handsomely: in 1992 dollars, a high school degree means over $212,000 more in lifetime earnings than some high school; some college adds another $172,000; and a bachelor's degree adds an additional $428,000 in lifetime earnings.

Specific Comments and Recommendations

Our specific comments and recommendations are as follows:

1. Goals Page 48714, column three, states that "Treasury seeks to bring into the mainstream of the financial system those millions of Americans who receive federal payments and who currently do not use the financial system to receive funds, make payments, *save*, borrow, or invest." (Emphasis added.) But when the specific goals for implementing the EFT requirements are later listed, saving is not included. The stated goal of "significantly increasing participation by recipients in the country's financial system" could be expanded to acknowledge that saving is essential to participating fully in the country's financial system.

⇒ ***Recommendation:* Add the explicit goal of facilitating savings as part of integrating the non-banked into the U.S. financial mainstream.**

2. Education Page 48719, column one, states that "The benefit agencies and the financial industry have developed, and are continuing to develop, educational materials that assist recipients with limited education or literacy skills in making the transition to EFT. In addition, Treasury intends to conduct an extensive education campaign on receiving payment by EFT."

This language is quite similar to that found in the economic literacy training programs offered in conjunction with IDA programs supported by CFED and others. We thus encourage Treasury to use the EFT requirement to foster broader economic literacy, including savings. This is consistent with Treasury's stated

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goal of bringing the unbanked into the mainstream financial system; more precisely, it is our view that "participating" in the mainstream financial system requires education well beyond making the transition to EFT.

⇒ ***Recommendation:*** **Use the EFT '99 requirement to promote broader economic literacy that includes savings.**

3. Treasury's Financial Agent(s) Page 48721, column two, states that Treasury intends to "engage one or more Federally-insured financial institutions to act as Treasury's financial agent for the provision of accounts to those [10 million] individuals [who do not have an account at a financial institution]." Further, Treasury plans to "obtain such account services through a competitive process."

The selection of the financial agent is obviously critical to the effective implementation of EFT. While Treasury is requesting specific comments on the design of the accounts that the financial agent will offer (see next comment), we recommend that Treasury consider making the unbanked's broad integration into the financial services mainstream (including savings opportunities) as an important criterion in the selection process. While we recognize that there is an inevitable tension between cost and features, we encourage Treasury to ensure that the competitive process through which the financial agents will be selected is beneficial to both the financial agent and the recipients. For example, Treasury could consider incorporating into the competitive process an incentive structure that values the options — such as offering free transfers from EFT transaction accounts to linked saving or investment accounts — it would like to see provided by the financial agent. Again, we encourage Treasury to incentivize banks to go beyond EFT and narrow transaction services in ways conducive to the longer-term well-being of low-income people and communities.

⇒ ***Recommendation:*** **Include savings facilitation as a criterion in selecting Treasury's financial agent.**

4. New Accounts for the Unbanked Page 48721, column three, states "While no final decisions have been made as to the attributes of the account, it is the preliminary view of Treasury that each recipient should have an individual account at a Federally-insured financial institution that can be directly accessed via plastic debit card at any location of that institution." The account, according to an accompanying fact sheet, will be called an "Electronic Transfer Account," or ETA. Comments are then requested on eight specific design features, the seventh (page 48722) being "Should the account include a savings feature?.....Would additional free withdrawals or the capability to accept deposits other than the Federal payment act to foster savings by the recipient?"

Given our view that, as stated, most saving in this country occurs because it is supported institutionally, and given the aforementioned history of poor people in the U.S. saving over $250 million through CDCUs, CFED resoundly answers "Yes" to both of these questions. However, a few questions and comments remain, as follows:

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- First, it is unclear to us, as described in the proposed rule, if the ETA would include a savings feature that is part of or separate from the ETA . That is, would there be one ETA that allows both transaction and savings features, or would there be two accounts, one for EFT transactions and another for savings? Perhaps this is an option; if it is, we recommend the latter. CFED would like to see a *separate* account with the purpose of facilitating saving among the unbanked, one that is linked to the ETA but not commingled with it.

- Second, and assuming that there would be a separate account for savings, we have to ask what kind of account it would be. Would it resemble a savings account (and thus serve as a place to hold savings and other deposits) or resemble a checking account (and thus serve as a place to hold *de facto* savings, other deposits, and allow payments and withdrawals including ATM and POS withdrawals)? Our sense is that, while checking *and* saving features would be nice, it would be best to offer a *low-cost, interest-bearing savings account with relatively few features.* At a minimum, we recommend allowing one or two fee-free transfers (to and from the account) and deposits (into the account) per month. However, this related account does not necessarily have to be regulated; the very existence of such an account will, we believe, encourage saving.

- Third, while CFED's interest lies in fostering savings, our particular interest centers on facilitating savings that lead to the acquisition of productive assets (especially post-secondary education, purchase of a first home, and capitalization of a small business). We accordingly encourage Treasury to consider providing incentives to the financial agent to also set up IDAs or other restricted accounts for recipients of EFT. Banks, in addition to earning revenue from holding these longer-term investment accounts, could receive CRA credit for establishing the IDA and additional credit for matching them. Transfers from either the ETA or (unrestricted) savings account into the IDA should be free of charges, while early or unauthorized withdrawals would, as is the case with IRAs, trigger a penalty (typically 10%).

- And fourth, we would like to point out again that in early experiments with EBT in several states, *de facto* savings (or balances) accumulated in many accounts. This not only suggests the ability of such accounts to foster savings by low-income people, it also provides an avenue for channeling such savings into higher-return saving and investment instruments, like IDAs. Also, while further research is needed to better understand the sources of such *de facto* savings, it is savings nonetheless and should, accordingly, earn interest, provided that the funds have accumulated over some minimal period (more than one month, for instance).

⇒ *Recommendation:* **Interest should be paid on any *de facto* savings that accumulate (after some minimal period) in the ETA.**

⇒ *Recommendation:* **A separate, low-cost, interest-bearing savings account should be set up to facilitate savings.**

⇒ *Recommendation:* **Savings in Individual Development Accounts should, in particular, be encouraged (with financial incentives or CRA credit) to facilitate the acquisition of high-return productive assets.**

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5. Sweep Accounts Page 48722, column three, states that "Treasury is aware that many brokers and dealers offer services that combine investment and transaction features. In these services, funds deposited into an account at a financial institution — which may be in the name of the securities broker or the name of the customer — are swept out of such an account on a regular basis and into an investment vehicle owned by the recipient....Treasury sees no reason to discourage recipients of Federal payments from using these services...."

CFED believes that this, too, could serve as a good model for incorporating IDAs or other savings vehicles into the EFT system. In fact, we encourage Treasury to provide incentives for the financial agent to regularly (monthly or quarterly) sweep the ETAs or savings accounts into the IDAs established (and perhaps matched) by the financial agent. If the financial agent does not provide this service, we encourage Treasury to encourage other financial institutions to partner with the financial agent to accomplish this. The partnering institution should receive CRA credit for doing so. The sweep could be structured to sweep the *de facto* savings from the ETA, a set amount from the ETA, or a set amount from the unrestricted savings account. It would not be unreasonable, we believe, for the financial agent to charge a fee for amounts (*de facto* or fixed) swept into the IDAs of other financial institutions.

And finally, we would like to say that we think that the "combine investment and transaction features" language seems right for all of our arguments in favor of tying EFT to savings and investment instruments.

⇒ ***Recommendation:*** **ETAs should be regularly (monthly or quarterly) swept into separate savings accounts or Individual Development Accounts.**

6. The Role of Non-Financial Institutions Page 48722, third column, states that "The proposed rule is silent on the role that non-financial institutions may play in the delivery of Federal payments to recipients with bank accounts and the relationship between non-financial institutions and such recipients. Treasury anticipates that non-financial institutions will continue to have the opportunity to partner with financial institutions and to market products and service to recipients....Treasury specifically invites comments on this opportunity for market innovations." It is also noted that "these relationships are distinguished from the account Treasury proposes to provide for individuals who do not have an account with a financial institution."

CFED believes that non-financial institutions have played and will continue to play a critical role in meeting the financial needs of people in low-income communities. We further believe that that role could be — and should be — expanded to accommodate the requirements of EFT '99 and to help alleviate the fair amount of anxiety that rightfully exists among the 10 million unbanked people for whom a relationship with a traditional financial institution has been unwanted, impossible, or inconvenient. In our view, it is simply hard to ignore the financial services and institutions that presently and popularly exist in low-income communities. These views were affirmed at the July savings meeting mentioned earlier.

The proposed rule points out that "Treasury cannot deliver a Federal payment by EFT directly to an entity other than a financial institution because electronic financial transactions are made primarily through the ACH network and membership in the ACH network is limited to financial institutions." Financial

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institutions, the rule states, include banks, savings banks, credit unions, savings associations, and U.S.-based foreign bank branches. The problem, however, is that — with the exception of 127 community development credit unions (CDCUs), which we hope will be fully utilized in the implementation of EFT '99 — there are very few financial institutions (as defined here) serving the millions of low-income people most affected by EFT. What, then, are the non-financial institutions serving low-income communities that could play a constructive role in implementing EFT, and what could that role be?

- *Check-cashing Institutions* As stated in the enclosed report, about 5,000 check-cashing institutions exist throughout the U.S. They already serve the unbanked and even those with bank accounts who need or prefer better accessibility and extended hours. The industry points out that it, through entrepreneurs, has already evolved an effective delivery system or infrastructure in precisely those areas where saving habits are most in need of support. Check-cashing institutions are in the "transaction" business, making them (in this sense) ideal outlets for EFT; it seems that check-cashing outlets could, therefore, serve as a point of access for funds held in Treasury-defined financial institutions. (They are also interested in developing savings products, albeit not account-based, thus also making them possible conduits for facilitating savings through EFT.) Now, we do recognize that the regulation of the check-cashing industry varies widely from state-to-state; fees are reasonable in some states and unconscionable in others. We therefore also recommend that, if check-cashing institutions are to become involved in the delivery of EFT (and any savings-related products), then regulations should also be developed, independent of any state regulations, to ensure that such transactions are effected at a reasonable and fairly uniform cost.

- *Community Development Financial Institutions (CDFIs)* As Treasury knows, CDFIs are financial intermediaries that have community development as their primary mission and develop a range of programs and methods to carry out that mission. CDFIs include, for example, community development banks, CDCUs, and community development loan funds. Well over 300 CDFIs exist in 45 states across the U.S. as the "bricks and mortar" financial institutions now serving low-income communities. CDFIs should, accordingly, be engaged in the implementation of EFT. Here it seems like Treasury's own CDFI Fund, which accredits CDFIs around the country, could work in conjunction with Treasury's Financial Management Service to implement EFT. From our perspective, it appears that CDFIs could (1) become points of access for EFT monies held by financial institutions, and (2) provide economic literacy to EFT recipients to help them more fully participate in the country's financial services system. While we would like to see CDFIs directly receive and administer EFT payments on behalf of low-income people, we understand that they are not — with the exception of CDCUs — Treasury-defined "financial institutions" and are thus not able to perform this function. Finally, as stated in the attached paper, CDFIs are well-positioned to mobilize and facilitate saving in low-income communities; they could, therefore, play an enabling role in fostering saving among recipients of EFT — especially, of course, if CDFIs serve as points of access for EFT monies.

- *Educational Institutions* CFED has found that economic literacy training is integral to the success of IDA programs around the country, and believe that it will also be integral to the success of EFT and Treasury's efforts to integrate low-income and unbanked citizens into the financial mainstream. More often than not, economic literacy training for IDA holders is offered by (or in conjunction

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with) local educational institutions such as schools, community colleges, and universities. We therefore encourage Treasury to engage these institutions both for individualized economic literacy training and for any broad, public education campaign in connection with the implementation of EFT '99.

⇒ ***Recommendation:*** **Non-financial institutions — notably check-cashers, CDFIs, and schools — should be included in the EFT system, primarily as a point of access for funds in ETAs and to provide economic literacy training. Regulations should be developed to ensure that funds can be accessed through non-financial institutions at a reasonable and fairly uniform cost.**

Summary and Priority of Recommendations

Our recommendations can be summarized and prioritized, as follows:

1. Add the explicit goal of facilitating savings as part of integrating the non-banked into the U.S. financial mainstream.

2. Interest should be paid on any *de facto* savings that accumulate (after some minimal period) in the ETA.

3. A separate, low-cost, interest-bearing savings account should be set up to facilitate savings.

4. ETAs should be regularly (monthly or quarterly) swept into separate savings accounts or Individual Development Accounts.

5. Savings in Individual Development Accounts should, in particular, be encouraged (with financial incentives or CRA credit) to facilitate the acquisition of high-return productive assets.

6. Include savings facilitation as a criterion in selecting Treasury's financial agent.

7. Use the EFT '99 requirement to promote broader economic literacy that includes savings.

8. Non-financial institutions — notably check-cashers, CDFIs, and schools — should be included in the EFT system, primarily as a point of access for funds in ETAs and to provide economic literacy training. Regulations should be developed to ensure that funds can be accessed through non-financial institutions at a reasonable and fairly uniform cost.

Closing Comments

In closing, we would like to say that we acknowledge that promoting savings, providing broader economic literacy training, and engaging non-financial institutions in the implementation of EFT '99 will not come without costs. We also know that EFT '99 is projected to save the Federal government as much as $100 million a year in processing costs alone. Further, we are confident that financial institutions (especially Treasury's

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designated financial agent) are likely and legitimately to profit from the requirements of EFT, both from transaction fees and the generation of new customers.

Most importantly, however, we want to ensure that the unbanked and low-income citizens — for whom these transfer payments exist — also get a "good deal." In fact, we believe that the substantial savings expected to be realized by EFT '99 should accrue primarily to the benefit of the unbanked and low-income citizens most affected by (and most concerned about) the new requirements. In particular, we would like to see a good portion of the savings realized dedicated to reducing the cost of (the relatively expensive) activities that support saving and financial inclusion, such as economic literacy training and transaction fees for deposits into savings accounts and IDAs.

A great opportunity does indeed exist through EFT '99 for financial inclusion, saving, and asset development. We hope that Treasury seizes that opportunity. Should you have any questions about these comments or the enclosed documents, please contact Ray Boshara at CFED's national office (202-408-9788).

Sincerely,

Robert E. Friedman
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Chair

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Enclosures (2)